St. John's Law Review

Volume 8, May 1934, Number 2 Article 31

Gain or Loss to Remainderman of Property Acquired by Bequest, Devise or Inheritance

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II. An annuity payable out of the corpus of the trust in the event of an inadequacy of income is taxable to the fiduciary,[29] but only to the extent that such annuity is met with payments from the income of the trust, there being, of course, no tax liability for such part of the annuity as is met with disbursements from the corpus. Such an annuity is not taxable to the recipient,[30] even although, in a given taxable year, the entire payment is met with income.

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GAIN OR LOSS TO REMAINDERMAN OF PROPERTY ACQUIRED BY BEQUEST, DEVISE OR INHERITANCE.—The basis prescribed under the Revenue Acts of 1924, 1926 and prior acts,[1] for determining gain or loss upon the disposition of property acquired by bequest, devise or inheritance, has resulted in much confusion, due to the contradictory interpretations of the acts by the courts, the Board of Tax Appeals and the Treasury Department. These acts[2] specifically provide that, "in case of property acquired by bequest, devise or inheritance, the basis (*i. e.*, for determining gain or loss upon a subsequent sale) should be *the fair market value of such property at the time of such acquisition.*" The Treasury Department's consistent attitude has been that in case of property (real and personal) acquired as a result of death, the date of acquisition was the date of the death of decedent.[3] This contention was based on the theory that immediately upon the decedent's death, a vested equitable interest in the property was acquired by the legatees. Upon distribution of the property, their title reverts to the date of death. The Board of Tax Appeals, however, held that the date of acquisition of property by specific legatees[4] and residuary legatees[5] was the date when the property bequeathed was actually distributed and made available to them, the value on that date being the basis for determining gain or loss upon a subsequent sale of the property by the legatees.[6] The Treasury

[29] Helvering v. Pardee, *supra* note 23.
[30] Burnet v. Whitehouse, *supra* note 3.

[1] REVENUE ACT OF 1924 §204 (a), (5), Reg. 65, art. 1594; REVENUE ACT OF 1926 §204 (A), (5), Reg. 69, art. 1594; REVENUE ACT OF 1921 §202 (a), (3), is substantially identical.
[2] *Ibid.*
[3] Reg. 74, art. 595; art. 1594, Regs. 69 and 65; Reg. 62, art. 1563; Reg. 45, art. 1562.
[4] Brewster v. Gage, 25 F. (2d) 915 (1927); Moser v. Commissioner, 12 B. T. A. 672 (1928).
[5] Foster v. Commissioner, 7 B. T. A. 1137 (1927); Mathiessen v. United States, 65 Ct. Cl. 484 (1928).
[6] See, particularly, Mathiessen v. United States, *supra* note 5.

Department's interpretation with respect to the basis under the 1926 and prior acts was finally upheld by the Supreme Court in the case of *Brewster* v. *Gage*.[7] In that case, despite the forceful argument of counsel for the appellant[8] that the date of distribution should control, the Court held that "the right of a residuary legatee to have his share of the residue after administration, vests immediately upon the testator's death. The decree of distribution confers no new right, it merely identifies the property remaining * * *." "The legal title so given relates back to the date of the death."[9] As a result of this, the Court of Claims' decision,[10] holding that a residuary legatee "acquires property only upon actual distribution to him," is no longer valid, under the Revenue Act of 1926 and earlier acts.

In respect to remaindermen this situation has given rise to two interesting aspects:

(1) where the interest of the remainderman is vested;

and

(2) where it is contingent.

As to when a remainderman's interest is to be deemed vested and when contingent, the Department's interpretation has varied. An early ruling held that the date when the remainder vests in possession was the date of acquisition.[11] Subsequently, this was overruled and the Department took the stand that the property is acquired when the interest vests in right,[12] although it may be subject to be divested.[13] The rule established in the *Brewster* case has been applied in cases where the property is held pending the outcome of litigation,[14] or during the intervention of a life estate,[15] or due to suspended distribution caused by a testamentary trust,[16] even where the will provides for distribution to the residuary legatee at future dates, and

[7] 280 U. S. 327, 334, 50 Sup. Ct. 115 (1930), *aff'd*, 30 F. (2d) 604, *rev'g*, 25 F. (2d) 915 (see *supra* note 4); Riddle, Adm. v. United States, 69 Ct. Cl. 332, 38 F. (2d) 527 (1930), reversing an earlier *contra* opinion held similarly.

[8] In the *Brewster* case (*supra* note 10) counsel argued that "to hold that property vests and is taxable at death of testator is to say that an increase or decrease in income is chargeable to taxpayer, before the property is subject to his disposition and control."

[9] Foster v. Foster, 20 Pick. 67, 70 (Mass.); Wager v. Wager, 89 N. Y. 161, 166 (1882); Thompson v. Thomas, 30 Miss. 152, 158.

[10] Mathiessen v. United States, 65 Ct. Cl. 484, certiorari denied, 278 U. S. 609, 49 Sup. Ct. 13 (1928).

[11] L. O. 649 (unpublished) cited in Sol. Op. 35, C. B. 3, 50.

[12] Sol. Op. 35, C. B. 3, 50.

[13] O. D. 694, C. B. 3, 53.

[14] Chapman, Jr., as Executor v. Commissioner, 19 B. T. A. 105 (1930).

[15] Griscom v. Commissioner, 22 B. T. A. 979 (1931).

[16] Chandler v. Field, 58 F. (2d) 370 (1932); Estate of Abelis *et al.* v. Commissioner, 24 B. T. A. 435 (1931); Security Trust Company, now Detroit Trust Co. *et al.*, Trustees, 25 B. T. A. 29 (1931); Barber Trusts v. Commissioner, 25 B. T. A. 513 (1932); Pringle *et al.* v. Commissioner, 26 B. T. A. 362 (1932).

for other disposition of the property in the event of death prior to such distribution.[17] Consistent with these holdings, the United States Circuit Court of Appeals arrived at a similar conclusion in the case of *Molter* v. *Commissioner*.[18] In this case the testator, who died in February, 1919, made provision in his will that, upon death of the life tenant, the taxpayer was to receive one-fourth of the estate, and was to receive the remaining three-fourths in payments of one-fourth of the residue each second year thereafter. If the taxpayer predeceased the life tenant the corpus of the estate was to go to taxpayer's lineal descendants. The life tenant died on April 25, 1923. The petitioner, in making her returns for 1925 and 1926, proceeded on the theory that under the terms of the will she had received a contingent remainder and that she actually (in view of the statute) acquired the property in 1923 and 1925. Therefore, she contended that the basis for determining gain or loss was the fair market value of the property in those respective years. Mr. Chief Justice Sparks, speaking for a unanimous Court, decided that the taxpayer acquired a vested interest in the property, as the provision for periodic payments did not render the remainder contingent,[19] and the basis for the gain or loss of property actually delivered to her by the trustee of the estate in 1923 and 1925 was the value at the date of testator's death on February 13, 1919. The same Court four days later was presented with an appeal, treating with substantially the same problem.[20] In this case the Court was called upon to determine whether a remainderman (taxpayer), who was given securities in 1926 under a testamentary trust created in 1915 had acquired them under the statute at the date of actual distribution (1926) or at the date of testator's death (1915). Again, Mr. Chief Justice Sparks, speaking for the Court, held that the rule as laid down in the *Brewster* case[21] is applicable and is extended to this case; that therefore petitioner acquired the securities, even though possession was to be postponed for an indefinite period, at the date of testator's death, and that their value at that date is the basis for gain or loss on a subsequent sale in 1927.[22]

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[17] Chandler v. Field, *supra* note 16; May *et al.* v. Commissioner, 26 B. T. A. 1413 (1932).

[18] U. S. C. C. A. 7th Circuit, decided January 22, 1934, *aff'g*, 27 B. T. A. 442.

[19] Smith v. Chester, 272 Ill. 428, 112 N. E. 325 (1916); GRAY, RULE AGAINST PERPETUITIES (1906) §108; Hertzig v. Goetten, 347 Ill. 619, 180 N. E. 428 (1932); Schofield v. Olcott, 120 Ill. 362, 11 N. E. 351 (1887); Drucker v. Burnham, 146 Ill. 9, 34 N. E. 558 (1893); Knight v. Pottgieser, 176 Ill. 368, 52 N. E. 934 (1898); Chapin v. Crow, 147 Ill. 219, 35 N. E. 536 (1893); Armstrong v. Barber, 239 Ill. 389, 88 N. E. 246 (1909); Walker v. Walker, 283 Ill. 11, 118 N. E. 1014 (1918); Bennett v. Bennett, 217 Ill. 434, 75 N. E. 339 (1905).

[20] Hopkins v. Commissioner, U. S. C. C. A. 7th Circuit, decided January 26, 1934, *aff'g*, 27 B. T. A. 845.

[21] *Supra* note 7.

[22] Huggett v. Burnet, 64 F. (2d) 705, *rev'g*, 24 B. T. A. 669 (1933); Chandler v. Field, 63 F. (2d) 13, certiorari denied, 289 U. S. 758 (1933);

It is evident from even a superficial reading of the portion of the statute relating to this question (Revenue Act of 1926 and prior acts),[23] and from the cases attempting logically to interpret it that its provisions are exceedingly ambiguous and are productive of controversy, especially in the determination of the date of acquisition of the property. This confusion has been eliminated to a great extent by the legislature in its passage of the Revenue Act of 1928. This Act provides:[24]

> "If personal property was acquired by specific bequest or if real property was acquired by general or specific devise or by intestacy the basis shall be the fair market value of the property at the time of the death of the decedent * * *. In all other cases if the property was acquired either by will or by intestacy, the basis shall be the fair market value of the property at the time of the distribution to the taxpayer."[25]

The above-quoted provision of the 1928 Act is continued without change in the Revenue Act of 1932.[26]

In *Lane* v. *Corwin*[27] (interpreting the Revenue Act of 1928) it was held that the basis of property in the hands of beneficiaries who received it at the termination of a testamentary trust for their benefit is the value of the property at the time of its transfer to the trust pursuant to the direction of the will. However, if the *cestui* has a mere contingent interest in the trust, so that "distribution" to him does not occur until the termination of the trust, the basis is the fair market value of the corpus at the time of such termination. The test is whether or not the interest of the *cestui* becomes substantially vested when the property is distributed to the testamentary trustee.[28]

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Lane v. Corwin, 63 F. (2d) 767 (1933); Security Trust Co. v. Commissioner, 25 B. T. A. 29 (1931); Rodman E. Griscom v. Commissioner, 22 B. T. A. 979 (1931).

[23] *Supra* note 1.

[24] §113 (a), (5).

[25] The "general" devise which is contemplated by the statute is evidently synonymous with the more commonly employed term of "residuary" devise. The status under the new statutory terminology of remainders created by will is uncertain. It is believed, however, that the general language of the statute applies to remainders, vested and contingent alike, and that the basis for the sale of property by a remainderman either before or after the property has vested in possession is the fair market value of the remainder at the time of the death of the decedent. KLEIN, FEDERAL INCOME TAXATION (1929) 847.

[26] §113 (a), (5).

[27] 1 Fed. Supp. 151 (1933).

[28] A full statement of the Department's position on this point is contained in G. C. M. 10260, I. B. B. XI—13, 2, as modified in G. C. M. 10698, I. R. B. XI—28, 6.